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BY: DEMIAN BRADY

IRS Silence on New 1099-K Paperwork Burdens Leaves Taxpayers In the Lurch

Introduction

Prior to the American Rescue Plan Act of 2021 (ARPA), the goal of the 1099-K form was limited to ensuring that taxpayers with substantial taxable income from third party sales on online platforms reported that income. Vendors did not have to file a 1099-K form for a taxpayer unless they had more than 200 transactions exceeding $20,000 in gross income.

ARPA changed that by dramatically lowering the threshold that requires third party payment systems to report information to the IRS using the 1099-K form. In the aftermath of ARPA, the $20,000/200 transaction threshold was replaced with a far lower threshold of just $600, with no transaction threshold.

This lower threshold eliminates the safe harbor for people who sell items online as an ongoing virtual garage sale, or who use services like Venmo to transfer money to friends and family or pay for a portion of a restaurant tab, payments that are generally non-taxable in any case.

With the lower threshold, it is easily conceivable that tens of millions of new 1099-K forms will be reported this year. This will increase compliance burdens and cause a great deal of unnecessary confusion for an as-yet countless number of taxpayers, many of whom stand to receive the forms from multiple vendors.

Key Facts:

The American Rescue Plan Act dramatically lowered the threshold for third party payment systems to produce 1099-K forms to taxpayers and the IRS. The $20,000/200 transaction threshold was reduced to $600, with no transaction threshold.

As a result, millions of new taxpayers will receive a 1099-K form this year, many will receive multiple forms from different vendors, adding to tax filing confusion and headaches.

The IRS has not revised its 1099-K paperwork burden estimate. A proper accounting of the compliance burden will help lawmakers determine whether the new revenue is worth the complexity and confusion added to the tax system.

But while this change will undoubtedly create an avalanche of new paperwork for both taxpayers and the IRS, this is not being reflected in official estimates of the burden of tax compliance. Under the Paperwork Reduction Act, federal agencies are supposed to report on the time and out-of-pocket cost burden that government forms impose on citizens. Despite the massive change in the 1099-K reporting requirements, impacting an unspecified but certainly massive number of third party vendors, businesses, and individual taxpayers, the IRS has not revised its paperwork burden estimate to account for this – nor are the forms currently under review.

The Impact of the 1099-K Threshold Change

The new reporting requirement is already impacting an untold number of taxpayers who use third party transaction vendors. And the universe of these vendors is large. With the rise of peer-to-peer technology, the expanded reporting requirement impacts widely used services and apps such as eBay, PayPal, Venmo, Uber, Lyft, Etsy, Amazon, Ticketmaster, StubHub, Shopify, Cash App, Google Pay, and Apple Cash, just to name a few.

Moreover, the 1099-K threshold is based on the gross value of the transactions, not net profit. So, if a person sells a high volume of low-priced items online, they could easily exceed the reporting limit over the course of the year because the amount encompasses the total payments received, regardless of the share paid for shipping through vendors like the U.S. Postal Service or other services. The seller sees no part of these shipping costs, but they end up in the gross totals that determine whether their data will be vacuumed up by the IRS.

If someone started a new account to sell something through one of these services this year, they were likely asked to provide a Social Security number first. The companies wanted to be sure they would be able to comply with the law and report financial transaction data. But given the privacy and cybersecurity risks involved, this requirement will no doubt cause trepidation and anxiety among people worried not just about the IRS looking over their shoulder into all their transactions, but also because of online thieves looking to drain bank accounts or steal someone's identity.

The IRS, tax advisors, and many of the third-party payment companies have engaged in efforts throughout this to raise awareness among the public about the significant change in the tax law. But undoubtedly there will still be many taxpayers confused by the arrival of 1099-K forms, and some may receive more than one. These people could easily be misled into thinking that this represents taxable income they must report, even though a large percentage of taxpayers affected by this lower threshold will likely have no taxable income reported on these forms at all.

After all, many Americans sell used items such as textbooks, old household items, and other used miscellany online when they no longer have use for them. These sales are non-taxable so long as the value of the sale is lower than the value the taxpayer originally paid for them, generally the case for these types of virtual garage sales. Nevertheless, a taxpayer can easily hit the $600 threshold on these types of sales and interpret the 1099-K they receive in the mail as indicating that these sales are indeed taxable.

The Biden administration and the Congressional Democrats who passed this change in ARPA did so in the hope of raking in a significant amount of new tax revenues. The Congressional Budget Office estimated it would generate $8.845 billion in new tax revenues through 2031, with $146 million in the first year and an average of $966 million through the rest of the decade.

The Government Has Failed to Account for the Change in Compliance Burdens

Although the provision will have a wide-ranging impact on filers of all incomes, the IRS has not calculated the change in the overall tax compliance burden this will cause. Any time any federal agency requires the public to fill out any sort of form, it is called an "information collection." The Paperwork Reduction Act requires agencies to estimate how long each respondent will take to fill out each form, as well as any potential out-of-pocket expenses incurred as a result. The estimates are reviewed and approved by the White House's Office of Management and Budget.

In general, federal agencies must get each collection re-approved on a three-year cycle, but most collections related to the tax system are reviewed every year. The 1099-K collection was last approved on January 31, 2020 and is set to be re-reviewed on January 31, 2023. The IRS's Supporting Statement for the information collection estimates that the form will generate 9,454,100 responses. Each response will take 29 minutes, imposing 4.529 million burden hours completing the form. The IRS was unable to calculate additional cost burdens imposed on respondents because no one replied to its request for public comment posted in the Federal Register on April 9, 2019.

We can calculate an estimate of the value of this time burden using private sector labor costs. According to the Bureau of Labor Statistics (BLS), U.S. non-federal civilian employers spent an average of $38.61 per hour worked by their employees in March, 2022. At this rate, the 4.529 million hours for the 1099-K represent a $175 million opportunity cost on the respondents.

With the additional reporting requirement, the use of the form will swell. The Coalition for 1099-K Fairness (whose members include eBay, Etsy, and other ecommerce service companies) estimates that 86 percent of online sellers in 2021 made less than $5,000 in gross revenues from their sales.

The lowered threshold will impact millions of additional taxpayers, with many receiving 1099-Ks from multiple vendors.

Even if the IRS were to update its 1099-K compliance burden estimate, this would only account for the time spent by the third-party vendors required to complete them, not the surprised taxpayers who will get one of them for the first time ever and then must devote time into understanding what the form means — let alone the potential for tax overpayment as confused taxpayers report non-taxable 1099-K income as taxable.

As enrolled agent Ryan Ellis explained to *Accounting Today*, there will be a lot of confusion for filers receiving a 1099-K for the first time, and the IRS is not in a position to answer questions, even with the additional $80 billion provided to the IRS in the Inflation Reduction Act. At the same time that they will be processing untold millions of new 1099-K forms, the agency has to implement complicated new taxes like the new corporate Alternative Minimum Tax and the 1 percent stock buyback tax.

A revised paperwork burden estimate will also fail to account for the time-draining and anxiety-inducing instances where people are asked to submit a Social Security number to use online services, and have to weigh sharing that data with the risk of the data being hacked.

The IRS may account for the taxpayers' compliance burden in its next revision of the burden estimates for the Individual Income Tax and the Business Income Tax collections. Those are not currently under review by OMB, but should be revised January 31, 2023 – 36 months since the last approval.

The Importance of Calculating Accurate Taxpayer Burden Costs

NTUF has tracked the time and expenses associated with complying with the tax code for many years, and the cost is substantial. According to our most recent analysis of data that the IRS is required to file as a result of the PRA, the overall net tax compliance burden is a staggering $339 billion. Because the IRS represents nearly two-thirds of the government-wide paperwork burden, it is crucial that the agency promulgates transparent and accurate paperwork burden estimates.

As noted above, the IRS was unable to calculate the cost-expense burden for the 1099-K form. In our latest examination of the compliance burdens of the tax system, NTUF noted that there are many other gaps in the IRS's taxpayer burden estimates under the PRA. IRS compliance with that law is important to help identify problem areas of the tax code. Taxpayers can play a role in this by filling out taxpayer burden surveys and providing public comment on IRS forms as those forms cycle through the Federal Register for regular review. The IRS can also do more to improve its models while also finding new ways to understand taxpayers' experience with the various tax forms so that burden estimates can be improved.

Ultimately, a proper and timely accounting of the 1099-K paperwork compliance burden will help lawmakers determine whether the new revenue is worth the hassles and headaches imposed on taxpayers. As NTUF President Pete Sepp said:

> It's about $7.8 billion in revenues raised from this new requirement, so just under $800 million a year, I can't imagine a situation where the paperwork burdens and the additional staff time in any way justify that kind of revenue. Think of potentially several hundred million 1099's being introduced into the document flow and tens or hundreds of thousands of personnel with extra reporting obligations. Then you think of the economic lock-in effects of folks who might no longer conduct casual online sales and just hold onto junk. The costs there far exceed the revenue gains in the long term.

Data Security and Enforcement Risks for Taxpayers

In addition to the confusion, time burdens, and extra expenses, innocent taxpayers could face additional problems as a result of the IRS's drastically expanded data collection effort. The Inflation Reduction Act (IRA) boosted the IRS's budget by $80 billion, with $46 billion dedicated to tax enforcement. Treasury Secretary Janet Yellen, whose department oversees the IRS, issued a directive that none of that new funding will be used to increase enforcement on taxpayers earning less than $400,000. The millions of new 1099-K flowing to the IRS will provide it an opportunity to expand enforcement on middle income taxpayers while abiding by Yellen's restriction regarding use of the IRA funding. NTUF's Vice President Joe Bishop-Henchman explains how the IRS operates:

> IRS officials collect mountains of data from employers, contractors, and financial institutions and feed them into the IRS computer. Any discrepancy automatically generates a letter sent to taxpayers, tens of millions a year.
>
> I've worked with many taxpayers who have received such letters, with the ominous IRS logo in the upper-left corner. The letter states that the IRS has identified a discrepancy and concluded that you are guilty. You can either pay immediately or send in your explanation proving your innocence. Most pay.

Millions of taxpayers could find similar ominous letters in their mailboxes.

There is another huge concern about the 1099-K threshold reduction: can the IRS properly secure this digital mountain of data? In June, 2021, there was a major leak of taxpayers' sensitive, private financial data. Sixteen months later, the leak is still under investigation, raising red flags about the integrity of the IRS's information systems.

Three new reports from the Treasury Inspector General (IG) for Tax Administration raises fresh concerns. The IG found that the IRS cloud services, for storing and sharing data, were implemented without key security controls. Much of the report, even the summary, is heavily redacted. One of the problems appears to be that the IRS does not have adequate event auditing protocols in place to track who is logging in to databases and accessing or modifying records. The second report, also widely redacted, warns that the IRS is not fully scanning its databases of sensitive taxpayer information for vulnerabilities, and in addition that the "IRS is not timely patching database vulnerabilities." The third report discusses security vulnerabilities within the IRS's mainframe platform that "can lead to unauthorized access, increased vulnerability to attacks, and unauthorized data sharing, all of which compromise the integrity, confidentiality, and availability of the platform and taxpayer data."

The leak incident and the IG's warning should give pause to efforts to have the IRS sweep up even more data from taxpayers.

Reforms Are Needed to Restore Safe Harbors for Taxpayers

Ultimately, the burden of fixing our cumbersome and increasingly complicated and confusing tax code rests upon the shoulders of lawmakers in Congress.

There is bipartisan support to address this problem, but currently there is a difference on how exactly to do that. Republicans have introduced legislation to repeal the ARPA threshold level, including Rep. Representative Carol Miller's (R-WV) Saving Gig Economy Taxpayers Act (H.R. 3425), Senator Rick Scott's (R-FL) bill S. 948, and the SNOOP Act of 2022 (H.R. 6913/S. 3546 introduced by Rep. Michelle Steel (R-CA) and Sen. Bill Hagerty (R-TN). This would return the current $600 threshold (with no transaction floor) to the $20,000 gross income and 200-transaction thresholds in effect before ARPA.

On the other side, Rep. Chris Pappas (D-NH) and Sen. Maggie Hassan (D-NH) introduced the Cut Red Tape For Online Sales Act (H.R. 7079/S. 3840), which would raise the threshold for reporting to $5,000 and have the IRS clarify when sellers need to file the 1099-K form.

Conclusion

As noted above, NTUF's annual tax compliance study tracks the time and expense burden imposed by the complexity of the tax system. In 2017, Americans spent 8.06 billion hours complying with tax laws. The Tax Cuts and Jobs Act of 2017 not only reduced tax burdens across the board, it also simplified tax filing. This freed up a lot of time for taxpayers. In 2020, it took taxpayers 6.08 billion hours. Unfortunately, the tax time burden rose in 2021 to 6.53 billion hours.

Without reforms, the changes to the 1099-K reporting threshold will impact millions of individuals, creating needless headaches and adding new complexity burdens. They also follow on the heels of several difficult years for taxpayers stuck waiting for the IRS to process its massive backlog of submitted tax returns. This has led to delayed refunds and anxiety for taxpayers who received warning letters sent out automatically by the IRS because it had failed to process a submitted return.

Lawmakers should increase safe harbor protections for taxpayers by rolling back the sweeping changes to the 1099-K reporting requirements. On top of that, lawmakers and IRS officials should be focused on ways to improve taxpayer services and simplify our overly burdensome tax system.

About the Author

Demian Brady is the Vice President of Research for National Taxpayers Union Foundation, where he runs the organization's Taxpayers' Budget Office.